



DEPARTMENT OF THE TREASURY OFFICE OF PUBLIC AFFAIRS

For Immediate Release
February 9, 2005

CONTACT: Brookly McLaughlin
(202) 622-1996

Statement of Donald V. Hammond Fiscal Assistant Secretary, U.S. Department of the Treasury Before the House Committee on Government Reform Financial Report of the United States Government Improves Government Accountability

Mr. Chairman and Members of the Subcommittee, it is my privilege and pleasure to represent the Treasury Department today to discuss the state of reporting on the finances of the federal government. Your continued interest in this important subject is appreciated. The Financial Report of the United States Government, incorporating the consolidated government-wide financial statements, is designed to report on the financial condition of the Federal government using the accrual basis of accounting employed and understood worldwide for financial reporting. The report for fiscal year 2004 was the eighth time that Treasury has prepared and issued this report pursuant to the requirements of the Government Management Reform Act of 1994. We have learned a lot over these past eight years and, while not always apparent, considerable progress has been made towards producing a timely, accurate and useful financial report. Perhaps even more importantly, the efforts to provide effective financial reporting have led to significant improvements government-wide in the underlying financial management practices and processes.

We are pleased this year to have issued the fiscal year 2004 Financial Report on December 15 meeting the objective the Administration set out three years ago. This is two and a half months after year end and a full three and one half months before the statutory due date of March 31. Much of the credit goes to the agencies whose data is the backbone of the report. Almost all the agencies met their November 15 deadline for the issuance of audited financial reports and every agency met Treasury's November 18 deadline for data input into our new report preparation system. At Treasury, we have been planning for this date and in particular the Treasury bureau, the Financial Management Service (FMS), worked extraordinarily hard to make this a reality.

This was a significant accomplishment considering that we also concurrently launched the first part of a new consolidation process which was designed to ensure that the agencies' financial statements are consistently included in the government-wide Financial Report. Further development work to complete the system is scheduled for 2005, which should make preparation of the report more efficient and allow us to resolve some longstanding audit findings.

Importance of the Report

The Financial Report has been an important addition to federal financial reporting. Prepared in accordance with accrual accounting standards established by generally accepted accounting principles (GAAP), the report presents a picture of government-wide finances that complements the traditional information in the budget and helps to assess the long-term impact of the government's policy decisions. The timely availability of this additional information can more fully inform the budget process.

The standardized reporting framework promotes comparability and consistency in reporting across years, among agencies and increasingly among countries using accounting conventions generally common to financial reporting. The report goes beyond simple reporting of results as it displays the effects of all significant assets, liabilities, stewardship responsibilities and other commitments and responsibilities. For example, the considerable financial implications of the government's social insurance programs (principally Social Security and Medicare) are reported in the stewardship accounting for these programs and discussed in Management's Discussion and Analysis. These future program responsibilities do not fit neatly into current accounting classifications. While the appropriate accounting treatment in the future for these social insurance programs is a current topic of discussion at the Federal Accounting Standards Advisory Board (FASAB), the existing standard provides for comprehensive disclosure.

Major Improvements to the Financial Report

We think this year's Financial Report shows significant improvement from the first one we prepared for fiscal year 1997. Many enhancements have been made over the last eight years. Additional information has been added and the presentation improved over the years which has increased the usefulness of the report to the reader. The report is presented showing both current and prior years. This comparative presentation provides additional context to the reader as one can see the change in an account from year to year. The Statement of Net Cost is presented showing cost by agency instead of by budget function. This provides a critical link to the presentation of the budget. It also makes it easier for us to ensure that the report is consistent with agencies' financial statements from which it is built and also gives agencies a feeling of ownership in the report.

We worked with the FASAB to add two new basic financial statements, 1.) a Reconciliation of Net Operating Cost and the Unified Budget Deficit and 2.) a Statement of Changes in Cash Balance from Unified Budget and Other Activities. The reconciliation statement ties our accrual results to the more widely recognized budget results and the cash statement reconciles the budget results to the change in cash during the year. We have made other additions to the report as required by FASAB, such as additional reporting on social insurance and the presentation of the Department of Defense's military equipment on the balance sheet.

Less visible but no less important, the discipline and rigor associated with the production of regular financial statements have resulted in improvements in basic financial operating activities. For example, the report that identifies differences between the agencies' and Treasury's records for fund balance with Treasury were reduced by 54 percent in FY 2004 alone. For fiscal year 1999, I testified that agencies were out of balance by \$401.3 million for differences greater than five months old. Today, for fiscal year 2004, those same differences are \$178.1 million using a more aggressive three month aging standard. In another area, eight years ago the details of the problems with intragovernmental transactions were more unknown than known. We can now break out intragovernmental differences by functional categories so key areas that need attention can be identified and addressed. Finally, the synchronization of budget and proprietary figures was greatly improved when FACTS II became operational in the last quarter of fiscal year 1999. The Statements of Budgetary Resources in agencies' financial statements are also an important link between the budget and proprietary areas. All of these

improvements have helped us hone in on those areas that need further attention and will be the focus of our activities this year.

Challenges

In order to pass audit scrutiny, we must address three major areas:

- Serious management control issues at DoD
- The government's inability to properly eliminate transactions between agencies
- Deficiencies in the report preparation process

DoD is making progress but much work remains. They are such a significant portion of the total financial picture that it is extremely unlikely that improvement in the audit opinion will occur without significant improvement in DoD reporting.

Two new initiatives were included in the 2004 report process that were designed to reduce the out of balance conditions that exist between agency transactions with other agencies. First we required significantly greater detail in the agency submissions so that we are better able to analyze the data. Second, we required agency auditors to review the out of balance conditions between the audited agencies and their trading partners in the hopes that greater auditor involvement would encourage agency management to accurately record and correct these balances. While it is too early to assess these initiatives, preliminary results are very encouraging.

The new report preparation system is a work in progress. We met our first phase objective for agencies to be able to fully utilize the data collection portion of the system to submit their financial statement data, but we still used a series of off-line processes to produce the final report. We plan to complete the consolidating portion of the system in 2005, which will aid us in demonstrating that the data used is consistent with the agencies' financial statements and greatly streamline the preparation process. That being said, a comprehensive draft of the Financial Report was produced in less than two weeks.

Progress in Addressing GAO Recommendations

GAO's audit enhances the report's credibility and highlights areas for improvement. The existing weaknesses in federal financial management have prevented GAO from being able to fully audit the report resulting in the issuance of a disclaimer of opinion. The preparation and audit of the past eight reports have revealed many deficiencies and areas for attention. This has resulted in improvements in the quality of the underlying financial information and the financial reporting systems and processes. It has also led to a better understanding of the government's financial operations. Through this rigorous and continuous process, we will improve our financial management environment and achieve more credibility in our financial reporting. Once we have achieved this level of credibility, we will have created the solid foundation for a better public understanding of the government's finances.

The new process we implemented for the FY 2004 reporting cycle used the agency financial statements to produce the Financial Report. Agencies use the Government-wide Financial Reports System (GFRS) to reclassify their financial statement line items to the corresponding line items required for the government-wide consolidated statements and provide additional information. While further enhancements to GFRS are needed, Treasury has laid the foundation for ensuring that the government-wide consolidated statements contain the same information as the agency financial statements. As our edits of agency data improve, we believe this aspect of the problem can be resolved in future years.

FASAB requires some disclosures that are not currently included in the government-wide financial report. For the fiscal 2004 reporting cycle, FMS asked agencies for data in the new report preparation system that relate to these particular FASAB-required disclosures. We are in the process of analyzing the 2004 footnote disclosure data submitted by the agencies to determine where the information is

material to the financial statements or for evidence that the disclosure is unnecessary due to immateriality. FASAB has also launched a project to determine which FASAB-required disclosures would not be necessary in a government-wide financial report. We are working closely with FASAB staff on this effort.

We continue to make progress on the problem of imbalances in intragovernmental transactions and are devoting increased attention to help agencies fully reconcile these differences. As I testified in July before the Senate Committee on Governmental Affairs, FMS has added a new tool to help agencies properly identify and record these intragovernmental transactions. The Intragovernmental Reporting and Analysis System (IRAS) is instrumental in classifying inter-agency activity and balances. It identifies different ways agencies describe the same transaction (one agency records an expense while the other capitalizes it). Additionally, IRAS provides information for agencies to help correct reporting errors, and assists them in reconciling major differences. IRAS offers a database solution for tracking quarterly accounting errors and timing differences and a systematic documentation of the different accounting methods used by agencies. Treasury and OMB now require agencies to report and reconcile intragovernmental activity quarterly instead of just at the end of the year. These more frequent reconciliations have already led to significant reductions in differences in agency reporting.

Other Improvements

Supporting the acceleration efforts has been our internal efforts to accelerate our reporting of monthly agency data to agency financial managers. The Monthly Treasury Statement, the monthly public source of budgetary results, has been accelerated in issuance from the seventeenth workday to the eighth workday facilitating agency efforts to verify and use the data in their reports.

As I have mentioned in the past, we continue with our plans to improve the routine outlay and receipt process. Presently we employ a two step process for these budgetary transactions. The first step relates to the transactions that record the collection of funds or the disbursement of funds. The second step takes those banking transactions and classifies them according to the appropriations authorized by Congress. Obviously if these two steps could be combined savings would result. In this case the savings would be significant. Estimates are that several thousand financial management staff members across government are involved in this classification process. On the outlay side the classification is known when the disbursement is requested. To have to go back later and classify these transactions is extremely inefficient. The sooner we can eliminate this step the sooner savings and process efficiencies can occur. We have a pilot scheduled for this coming fall. If that goes as planned we will be implementing this new feature in the coming years to the benefit of every single agency across government.

Conclusion

We continue to make substantial progress on reaching our objective of effective financial reporting and sound financial management. Through the efforts to date, numerous issues have been identified, corrective actions instituted and processes changed. Serious challenges remain before we reach our objective but we understand our tasks and our commitment to resolving them is firm. As I have previously stated, improved financial reporting leads to the ultimate benefit of effective financial management. As the stewards of taxpayer funds, our responsibility is to meet the highest standards of financial management.

In conclusion, we have come a long way, our upcoming challenges are significant but manageable, and I am confident that we will continue to see real progress. Thank you, Mr. Chairman. This concludes my formal remarks.